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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690	)	
	)	CC Docket No. 94-157
NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No 328	)	

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REBUTTAL OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT) hereby submits its Rebuttal to the Opposition filed by MCI Telecommunications Corporation (MCI) on September 13, 1995. MCI filed the only opposition to the LEC Direct Cases. The MCI opposition is notable for its brevity. However, in its brevity, it fails to make any valid claims against SWBT's Direct Case.

In general, the MCI opposition appears to be improperly tempting the Commission to reject the filed OPEB amounts on arbitrary and unsubstantiated grounds. Such a rejection would result in a further reversal from the U.S. Court of Appeals similar to the Court's 1994 decision in Southwestern Bell v. FCC.[1]

As SWBT's Direct Case explains, SWBT has fully complied with the standards for exogenous cost treatment that were in place at the time SWBT requested such treatment. None of the standards with which MCI attempts to judge the LEC filings is grounded in the Rules as they existed at the time of the LEC tariff filings. The Commission should ignore this attempt by MCI to arbitrarily alter

[1] Southwestern Bell Telephone Company v. FCC, 28 F.3d 165 (D.C. Cir. 1994).

the standards for judging the LEC tariff filings and OPEB exogenous amounts, reject MCI's opposition, and end the investigation and accounting order to which the LEC tariffs have been subjected.

I. NO NEW EVIDENCE IS NECESSARY TO SUPPORT SWBT'S FILING.

MCI claims that the LECs have filed "no new evidence" to support the OPEB exogenous cost claims.[2] However, this allegation provides no basis to reject SWBT's tariffs.

By its request for new evidence, MCI is trying to change the proceeding into something that it is not. The Designation Order[3] specifically requested that LECs "refresh the record" which had become "stale." For good reason, the Commission did not request "new" evidence in this proceeding. All relevant evidential matter that could possibly be needed has already been filed. The SFAS-106 investigation has already taken 42 months, and SWBT has filed approximately one thousand pages of materials to support its filings.

MCI's request for new evidence is nothing more than an attempt to have the Commission undertake inappropriate avenues of inquiry and to further lengthen this proceeding. Further, as

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[2] MCI at p. 2.

[3] 1993 Annual Access Tariff filings, CC Docket No. 93-193, Phase I, 1994 Annual Access Tariff filings, CC Docket No. 94-65, AT&T Communications Tariff F.C.C. Nos. 1 and 2, Transmittal Nos. 5460, 5461, 5462 and 5464, CC Docket No. 93-193, Phase II, Bell Atlantic Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 690, CC Docket No. 94-157, NYNEX Telephone Companies Tariff F.C.C. No. 1, Transmittal No. 328, Order Designating Issues for Investigation (DA 95-1485) (Com. Car. Bur., released June 30, 1995) (Designation Order).

stated by Peter Neuwirth and Andrew Abel, the authors of the original study report upon which SWBT continues to rely,

> the conservatism in our original report was designed to guard against understating the impact of SFAS-106 on the GNP-PI even if new data turned out to be moderately different from the assumptions used in the study.[4]

Thus, no new evidence was necessary.

MCI claims that "the LECs have done nothing to further their case by relying on previously filed explanation."[5] MCI specifically criticizes SWBT for its referrals to its 1993 Direct Case. MCI by its Opposition, incorrectly claims that in the Designation Order the Commission designated issues for further investigation because the comments previously filed by the LECs were deficient.[6]

On the contrary, SWBT's previously filed material thoroughly explained SWBT's implementation of SFAS-106 and documented all of the related cost calculations. SWBT's documentation included references to data sources, explanations of calculations, and audit trails to substantiate compliance with the Commission's Rules and cost calculations.[7] Further, SWBT thoroughly substantiated amounts of pay-as-you-go expenses included in its rates prior to the implementation of price caps, including

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[4] "Supplemental Report: Perspectives on Analysis of Impact of SFAS 106 on GNP-PI," by Peter J. Neuwirth and Andrew B. Abel, September 28, 1995, p. 9.

[5] MCI at p. 6.

[6] MCI at pp. 5-6.

[7] SWBT did not refer to its 1993 Direct Case, as claimed by MCI, in providing SWBT's support. SWBT referred to the Description and Justification of its 1993 Annual Access Tariff Filing.

the referenced portions of Tariff Review Plan Reports. To refresh the record, however, SWBT has reproduced and referenced all of those documentations in its 1995 Direct Case.

The Designation Order specifically did not find that SWBT's previously filed material was deficient. In fact, the Designation Order stated:

> We seek some of the same type of cost information sought in the initial OPEB Investigation. The OPEB Order did not reach the merits of the record on these cost issues for individual LECs because it determined that SFAS-106 amounts should not receive exogenous treatment generally.[8]

Thus, the Commission did not determine that the detailed cost data provided by SWBT was insufficient. The Commission in the instant proceeding was simply seeking to "refresh" the record on the various issues designated for investigation. Also, MCI does not offer any evidence in its Opposition to support its claim that the information submitted by SWBT was insufficient.

II. MCI'S CRITICISMS OF THE NEUWIRTH/ABEL STUDY ARE COMPLETELY WITHOUT MERIT.

MCI claims that the Neuwirth/Abel Study sensitivity results indicate extremely different results based upon the varying of starting point assumptions.[9]

While MCI's current criticisms of the Neuwirth/Abel Study (i.e., the Godwins Study) are not new and have been extensively answered in previous filings, Peter Neuwirth and Andrew Abel, the

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[8] Designation Order at para. 15.

[9] MCI at p. 3.

authors of the original study, have prepared a response.[10] That response is included here as Attachment A. Neuwirth and Abel demonstrate that "MCI's opposition [of the study] is without merit and reflects a failure to understand the modelling and economic analysis in our reports."[11]

The sensitivity analyses performed by Neuwirth and Abel in 1993 were performed at the specific request of then-members of the Common Carrier Bureau's Tariff Division staff and were not then and cannot be represented now as reasonable estimates of the GNP-PI effects. As Neuwirth and Abel have explicitly stated on numerous occasions, "our sensitivity analysis presents the results for all combinations of parameter values, including many combinations too implausible to merit any attention."[12] Thus, MCI's implication that the wide range demonstrated by the Neuwirth/Abel sensitivity results should not be used is based upon a grain of truth: the implausible combinations were never intended for use in the calculation of the proper exogenous amount.

MCI also criticizes the Neuwirth/Abel Study for starting with different assumptions regarding competitive sector pricing behavior than utilized in the NERA Study.[13] As previously shown, the original Neuwirth/Abel assumptions are, in fact, conservative, relative to the assumptions in the NERA Study. The Neuwirth/Abel

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[10] "Supplemental Report: Perspectives on Analysis of Impact of SFAS 106 on GNP-PI," Peter J. Neuwirth and Andrew B. Abel, September 28, 1995.

[11] Attachment A, p. 2.

[12] Attachment A, p. 7.

[13] MCI at p. 3.

Study result would show even less of a "double count" if the NERA assumptions were used.

SWBT based its filings, and claimed exogenous amounts, on the more conservative figures that came from the Neuwirth/Abel Study. The Commission cannot just reject both of the differing assumptions in the NERA and Neuwirth/Abel Study without providing guidance on the correct assumption to be used.[14] At that point, SWBT and the other LECs relying on the Neuwirth/Abel Study would have to be given a reasonable opportunity to show why that assumption would not result in a double count that measurably differed from that estimated by the Neuwirth/Abel Study.

III. SWBT'S FILED ASSUMPTIONS ARE REASONABLE.

MCI claims that some of the assumptions filed by the LECs appear suspect.[15] On the contrary, SWBT's filed assumptions are reasonable.

SWBT's filings have illustrated that SWBT's SFAS 106 amounts are indeed reasonable. The bases for all of the exogenous amounts are the underlying actuarial studies. These studies have been performed in accordance with all SFAS-106 requirements as well as standard actuarial principles. These studies have been reviewed by external auditors and the resulting amounts published in various reports to the SEC and stockholders.[16]

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[14] Southwestern Bell Telephone Company v. FCC, 28 F.3d 165, 172.

[15] MCI at p. 6.

[16] These actuarially determined amounts have been separated and allocated in accordance with long-standing Commission Rules (Part

(continued...)

Additionally, a thorough macroeconomic and actuarial analysis study was conducted to estimate the percentage by which SFAS 106 costs would impact the GNP-PI and therefore already be considered in the Commission's price cap formula. This analysis used a very conservative approach which tended to overstate any realistic effects on the GNP-PI.

Finally, an amount which was intended to represent the current level of costs for postretirement benefits was subtracted to arrive at the incremental amount. In SWBT's case, SWBT used an estimate for 1993 of actual claims on the pay-as-you-go basis. This estimate was conservative and, based upon SWBT's analysis of the operation of the price cap formulas,[17] substantially exceeded the actual amount of cost currently embedded in SWBT's price cap rates.

IV. MCI MISCHARACTERIZES THE LEC PLANS.

MCI implies that some of the LEC plans are "overly generous."[18] This allegation is a thinly-veiled attempt to introduce an inappropriate "control" standard for the claimed exogenous amount. Notwithstanding MCI's claim, MCI fails to point

[16](...continued) 64, which identifies amounts as regulated or nonregulated; Part 36, which separates regulated expenses between the interstate and intrastate jurisdictions; and Part 69, which allocates interstate amounts to the appropriate interstate service categories and price cap baskets).

[17] See SWBT's Direct Case, filed August 14, 1995 in CC Docket No. 94-157 at p. 3 and Attachment 3 (1995 Direct Case).

[18] MCI at p. 6.

to even one LEC program as an example, and MCI's charges should be dismissed as totally unsubstantiated.

Moreover, MCI's charge cannot be applied to SWBT's postretirement benefit plan. SWBT seeks to provide a fair total compensation package which balances the needs of customers, employees, retirees and shareholders.

SWBT's 1993 Direct Case specifically explained that SWBT does not have control over accounting for OPEB amounts.[19] Since the "control" test has already been satisfied, given SWBT's inability to "control" the event which caused the change in SWBT's accounts (Southwestern Bell v. FCC, 28 F. 3d 165, at 169-171), MCI's charges have already been answered, decided, and are now irrelevant. MCI did not appeal the Court's decision and should not be allowed to reargue this issue.

Despite the fact that the Commission is not examining the control issue in this proceeding, SWBT has previously presented extensive evidence demonstrating that it has been a pioneer in implementing health care management systems.[20]

Further, MCI incorrectly tries to equate a "100% employee participation" with an "overly generous plan." SWBT did not assume 100% employee participation rate, it utilized a defined-dollar

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[19] Direct Case of SWBT filed in CC Docket No. 93-193 on July 27, 1993, at pp. 9-27 (1993 Direct Case).

[20] See SWBT's Direct Case, filed in CC Docket No. 92-101, on June 1, 1992, pp. 12-13 and Exhibit 2 (1992 Direct Case); SWBT's 1993 Annual Access Tariff Filing, Transmittal No. 2271, Description and Justification, Section 3.A., pp. 15-20, filed April 2, 1993.

benefit cap and a 100% retiree participation rate.[21] Moreover, MCI completely ignores the interaction between retiree participation rates and the defined-dollar benefit cap in SWBT's plan.

V. CONCLUSION

For the foregoing reasons, SWBT respectfully requests that the Commission affirm that SWBT's request for exogenous treatment has been reasonably calculated and should be granted.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

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September 28, 1995

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[21] Based on mortality and separation, the SWBT employee participation, to the extent it represents a meaningful concept, is much less than 100%.

ATTACHMENT A

SUPPLEMENTAL REPORT

PERSPECTIVES ON ANALYSIS OF IMPACT

OF SFAS-106 ON GNP-PI

Supplemental Report

Perspectives on Analysis of Impact of
SFAS 106 on GNP-PI

September 28, 1995

Towers Perrin

Introduction

Over the past four years, we have been working with various Price Cap LECs to analyze the impact of SFAS 106 on the GNP-PI. In February 1992, we issued our original report indicating that less than 1% of the Price Cap LECs' additional costs due to SFAS 106 would be reflected in the GNP-PI, and that approximately 85% of the LECs' additional costs would not be reflected in the GNP-PI or recovered through other macroeconomic effects.

Earlier this year, we were asked to provide an opinion as to the extent to which the findings of our original report, issued three years earlier, should still be considered valid. On August 14, 1995 we issued a report stating that we believe that the actual impact of SFAS 106 on the GNP-PI and the percentage of LECs' additional costs due to SFAS 106 that remain unrecovered were not materially different than indicated in our original report.

In September 1995, MCI submitted an opposition to our August 14, 1995 report. We find that MCI's criticisms in its opposition are completely without merit. There is nothing in MCI's opposition that would lead us to modify any of the findings in our original report or in subsequent reports we have prepared on this issue. This report provides a detailed response to MCI's submission.

Respectfully submitted,

Peter J. Neuwirth, F.S.A., M.A.A.A.

Andrew B. Abel, Ph.D.

S:/64797/95ret/neuwirp/r922usta.wpd

Executive Summary

MCI's opposition is without merit and reflects a failure to understand the modeling and economic analysis in our reports. This report clarifies and further explains the motivation and implementation of the economic analysis underlying our reports. In addition, we discuss in detail MCI's various criticisms and show that they are baseless. The specific points discussed in the body of our report are summarized below.

1. Despite MCI's criticism of our model as a "what-if" model, the question of the impact of SFAS 106 on the GNP-PI is precisely a "what-if" question. To address this question quantitatively, we need to determine how much different the GNP-PI would have been if SFAS 106 had not been introduced.

2. Using a set of five criteria outlined in our original report, we decided to use a quantitative general equilibrium model to analyze the impact on the GNP-PI of the introduction of SFAS 106. The numerical values of the model's parameters were chosen by a method known as calibration, which uses existing econometric estimates to determine the numerical values of some parameters, and chooses the values of other parameters so that the values of certain variables in the model match the actual values of these variables in the economy. MCI's criticism of the choice of numerical values for parameters reflects an ignorance of calibration in quantitative general equilibrium models, a method that is widely used in modern macroeconomic analysis.

3. The specification and calibration of the macroeconomic model was guided by a conservative philosophy which, in this context, guards against understating the impact of SFAS 106 on the GNP-PI. It also guards against overstating the percentage of LECs' additional costs due to SFAS 106 that remain unrecovered after taking account of the GNP-PI and other macroeconomic effects.

4. The extensive sensitivity analyses performed earlier produce a wide range of numerical results, but the most extreme results are based on combinations of parameter values that are too implausible to be taken seriously. The sensitivity analyses support the conclusion that only a small fraction of LECs' increased costs due to SFAS 106 are recovered through the GNP-PI, and even taking account of other macroeconomic effects, the majority of additional costs will be unrecovered.

5. Despite the fact that the NERA study and our original report used different assumptions about the extent to which the accrual of future OPEB's is a factor in the determination of prices in the absence of SFAS 106, our model can be extended to include the NERA assumption. This extension was implemented in the March 1993 Supplemental Report. Despite some quantitative differences in the findings using the two assumptions, the results are consistent with each other in that for both sets of assumptions the effect on GNP-PI is tiny and a very large fraction of LECs' increased costs due to SFAS 106 remains unrecovered. Although MCI criticizes our model for its ability to incorporate the NERA assumption, we regard this flexibility and the

similarity of substantive findings as reinforcing the results in our original report.

6. In light of the findings above, the criticisms raised by MCI are entirely without merit and would not lead us to modify any of the conclusions of our previous reports.

Rebuttal to MCI

MCI Telecommunications Corporation's Opposition to Direct Cases reflects a continued misunderstanding of the basic economic approach underlying our original report and of quantitative economic analysis in general. In this report, we discuss the basic methodological issues underlying our original report and explain why MCI's criticisms of the methodology are confused and without merit.

"What-if" Analysis

A glaring example of MCI's misunderstanding is the criticism of our model as a "what-if" tool[1]. As we have emphasized elsewhere,[2] a "what-if" analysis is the only way to calculate the impact of SFAS 106 on the GNP-PI. The impact of SFAS 106 on the GNP-PI equals the *actual value of the GNP-PI in a given year after the introduction of SFAS 106* minus the value of the GNP-PI that would have been observed in that same year if SFAS 106 had not been introduced. To estimate the value of GNP-PI that would have been observed in the absence of SFAS 106 we must ask "What would have been the value of the GNP-PI if SFAS 106 were not introduced?" This is precisely the sort of "what-if" exercise that is criticized by MCI. Although MCI seems to prefer the use of an econometric model, it appears oblivious to the fact that using an econometric model to address the impact of SFAS 106 on the GNP-PI is also a "what-if" exercise.

The Roles of Modeling and Econometrics

Any quantitative study of the impact of SFAS 106 on the GNP-PI must make a methodological decision about the type of model to use. In our original report we listed a set of five criteria to guide the choice of a model, and we explained why these criteria led us to use a quantitative general equilibrium model[3]. As explained elsewhere, large-scale econometric models fail to satisfy two of these criteria[4], and thus these models were deemed inappropriate for our study. Because MCI continues to criticize our model for not being "an econometric model capable of determining with some degree of statistical confidence the impact of SFAS 106 on GNP-PI."[5] we will revisit the issue of model design from a fresh perspective.

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[1] MCI, p. 5

[2] Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992, p. 23.

[3] Analysis of Impact of FAS 106 Costs on GNP-PI, February 1992, pp. 26-27.

[4] Response to Paragraph 16 of FCC Order of Investigation and Suspension, May 26, 1992, pp. 1-2.

[5] MCI, p. 4

To see why MCI's criticism is misguided, it is helpful to understand the role of modeling and the role of econometrics in addressing the question of the impact of SFAS 106 on the GNP-PI.

The Role of Modeling. In order to determine the effect of SFAS 106 on the GNP-PI we need a macroeconomic model that takes account of the interactions of the demand for goods, the production function, and the supply and derived demand for labor, and uses these interactions to simultaneously determine prices, wages, and other labor costs. A model is a set of equations that represent various aspects of economic behavior. The general mathematical form of our model is presented in detail in Appendix C of our original report.

The Role of Econometrics. Once a general mathematical model is formulated, the numerical values of the model's parameters need to be selected. Econometric estimation is a statistical technique to choose these numerical values. Our original report does not produce its own econometric estimates of the parameters. Instead the report relies on the results of previous econometric studies in the literature for guidance in choosing the values of parameters. As discussed in our original report,[6] the value of the elasticity of labor supply was chosen based on a survey of the econometric literature on labor supply in Labor Supply by Mark R. Killingsworth. The value of the price elasticity of demand was chosen to be very conservative based on the summary of econometric estimates of price elasticities of demand reported in Economics by Michael Parkin[7].

There are two advantages to using previous econometric studies rather than producing a new set of econometric estimates for calculating the impact of SFAS 106 on the GNP-PI. First, these previous studies can be viewed as being truly unbiased with respect to the issue of the effects of SFAS 106 on the GNP-PI because they were conducted without any reference to this issue. Second, rather than rely on the results of any single econometric exercise, we have based our choices of parameters on a body of research comprised of many studies. Moreover, in using these previous econometric studies to determine the values of parameters, we have been conservative in the sense discussed in the next section.

As we have just discussed, our original report does not perform its own econometric analysis and the model used in that report is not an econometric model, though the model does rely on econometric estimates for some of its parameter values. The numerical values of other parameters are chosen so that the model produces values for some variables that

[6] Analysis of Impact of FAS Costs on GNP-PI, February 1992, p. 30.

[7] A brief summary of the findings reported by Parkin is contained in footnote 4 on page 12 of Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Additional Sensitivity Analysis, March 1993.

match the actual values in the economy. For instance, the parameters of the production function are chosen so that the share of labor cost in total cost in the baseline calculation matches the share of labor cost in total cost in the U.S. economy. This approach to choosing numerical values of parameters, which uses both previous econometric estimates and parameter values that allow the model to match certain data, is known as *calibration*[8]. Calibration is commonly used in modern macroeconomic analysis to select parameter values in quantitative general equilibrium models.

The Conservative Approach

As we have discussed, calculation of the impact on the GNP-PI of the introduction of SFAS 106 is a "what-if" exercise. This calculation necessarily involves estimation of how much different the GNP-PI would have been if SFAS 106 had not been introduced. Because we cannot rerun history and alter it to exclude SFAS 106, nor can we run a controlled experiment, any calculation of the impact of SFAS 106 is an approximation rather than an accurate and precise determination of the exact impact. Recognizing the approximate nature of any such calculation, we adopted a conservative approach to guide the analysis in our original report. In this context, "conservative" means that our calculations tend to overstate the impact on the GNP-PI and thus to understate the fraction of LECs' additional costs due to SFAS 106 that remain unrecovered.

The conservative approach guided both the actuarial and macroeconomic analyses in our original report.[9] The baseline findings of the original report are that ultimately the increase in GNP-PI (0.0124%) caused by SFAS 106 will provide recovery of 0.7% of the LECs' increase in costs due to SFAS 106, and that taking account of additional macroeconomic effects that might occur, 84.8% of the increase in costs remains unrecovered. The March 1993 Supplemental Report also presents a "best estimate" set of results, which are not subject to the conservative influence guiding the baseline calculations. For example, according to our best estimates, only 0.3% of the increase in LECs' costs due to SFAS 106 are recovered through the GNP-PI. Furthermore, a comparison of the "best estimate" and "baseline" findings supports our original report in two ways. First, the two sets of findings are not very different from each other. Second, the baseline calculations featured in our original report are indeed conservative relative to our best estimates

[8] Calibration is discussed in Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992, pp. 40-41. Response to Paragraph 16 of FCC Order of Investigation and Suspension, May 26, 1992, pp. 3-5, gives a complete description of the calibration of the parameters in our model.

[9] The conservative approach is explained in Analysis of Impact of FAS 106 Costs on GNP-PI, Supplemental Report: Responses to Objections Raised Regarding Original Study, July 1992. See footnote 4 on page 16 of that report for a discussion of conservatism in the actuarial analysis, and see page 32 of that report for a discussion of conservatism in the macroeconomic analysis.

The Role of Sensitivity Analysis

In addition to comparing the best estimate and baseline results, we have performed extensive sensitivity analyses.[10] Our August 14, 1995 report[11] discusses the purpose of sensitivity analysis and explains why many of the calculations in our sensitivity analyses should be ignored because they were based on combinations of implausible parameter values. This report clearly and emphatically states that the range of parameter values used in the extensive sensitivity analysis was chosen to make sure that all plausible combinations of parameter values were included, with the recognition that many of these combinations were implausible and should be ignored. It is important to keep in mind that the purpose of the sensitivity analysis is not to delineate the set of plausible combinations of parameter values, but is instead to explore the robustness of our findings and to illustrate the quantitative impact on our findings of various changes in the numerical values of the inputs. Despite this discussion, MCI continues to criticize our findings because they present "extremely wide ranging results of GNP-PI effects".[12] However, this criticism has already been addressed by the detailed discussion of this issue on pp. 4-5 of the August 14 report. Nothing in the MCI opposition addresses any of the substantive arguments on pp. 4-5 of that report, so there is no point in repeating the details of that argument, except for the closing sentence: "To reiterate, our sensitivity analysis presents the results for all combinations of parameter values, including many combinations too implausible to merit any attention."

Reconciliation with NERA's Analysis

MCI points out that our original report and the NERA study start with different assumptions about the pricing behavior of competitive (unregulated) firms[13]. The difference between the two studies relates to the extent to which firms take account of the current accrual of future OPEB's (other postretirement employee benefits) when pricing their products. To the extent that firms understand and calculate the actuarial value of future OPEB's, the accrual of these OPEB's would be factored into prices by rational forward-looking competitive firms. NERA has chosen to follow the conventional economic assumption that competitive firms are rational and forward-looking and thus assumes that prices would reflect the accrual of future OPEB's even without SFAS 106. However, many workers producing output on any given date will not receive OPEB's until decades later. The calculation of the accrual of these OPEB's is a detailed actuarial task, and some firms may not have the expertise, foresight or inclination to compute and take account of these far-off costs in the absence of SFAS 106. The introduction of SFAS 106 may force such firms to only then factor these costs into their

[10] Our original report contains a sensitivity analysis, and the March 1993 Supplemental Report contains a much more extensive sensitivity analysis.

[11] "Perspectives on Analysis of Impact of SFAS 106 on GNP-PI".

[12] MCI, p. 3

[13] MCI, pp. 3-4

pricing decisions. Consistent with the conservative approach, our original report is based on the assumption that firms ignore the accrual of OPEB's before SFAS 106 and take account of these accruals when SFAS 106 is introduced. Relative to the assumption adopted by NERA, this assumption leads to a larger (i.e., more conservative) impact of SFAS 106 on the GNP-PI and to a lower percentage of the LECs' increase in costs due to SFAS 106 that remains unrecovered.

While NERA's study and our original report used diametrically opposed assumptions about pricing behavior in the absence of SFAS 106, one might reasonably assert that the actual behavior of firms lies somewhere between these extremes. Our March 1993 Supplemental Report[14] recognizes that the assumptions used by NERA and by us are at opposite ends of a spectrum and presents calculations of the impact of SFAS 106 for assumptions at both ends of the spectrum (corresponding to the NERA assumption and our assumption) as well as for various intermediate assumptions. If the actual behavior of firms is somewhere between the opposite assumptions used by NERA and by us, then these intermediate assumptions may better reflect the actual behavior of firms. However, one must not lose sight of the conservative approach guiding our original report. According to our approach, when we are unsure about which of a set of potential assumptions to adopt, we will adopt the one that leads to the largest calculated impact of SFAS 106 on the GNP-PI. The results reported on page 5 of the March 1993 Supplemental Report illustrate that the assumption used in our original report is indeed conservative relative to the assumption used by NERA and relative to intermediate assumptions.

MCI (pp. 4-5) mentions the calculations in the March 1993 Supplemental Report that use the NERA assumption about pricing, and criticizes these calculations because they illustrate that our model is a "what-if" model. This criticism is entirely off target. First, we have already explained why a "what-if" model is needed to calculate the impact of SFAS 106 on the GNP-PI. Moreover, these calculations can be viewed as adding an extra dimension to the sensitivity analysis. Recall that a sensitivity analysis indicates the quantitative impact on the results of changing various parameters or equations in a model. The calculations reported on p. 5 of the March 1993 Supplemental Report constitute a sensitivity analysis focusing on the assumption underlying pricing behavior. This sensitivity analysis reinforces the major quantitative findings of our original report: the introduction of SFAS 106 has a minuscule effect on the GNP-PI; and an overwhelming share of LECs' additional costs due to SFAS 106 remain unrecovered. Rather than being a point of vulnerability, these calculations are a source of strength and reinforce the findings in our original report.

[14] Analysis of Impact of FAS Costs on GNP-PI, Supplemental Report: Additional Sensitivity Analysis, March 1993, pp. 3-5.

Conclusion

The criticisms raised by MCI are entirely without merit. There is no serious argument in MCI's statement that would lead us to modify any of the findings in our original report or in any of our subsequent reports. MCI's characterization of the calculations in that report as "nothing more than a random and indiscriminate exercise" is irresponsible and reckless and reveals complete ignorance of the state of quantitative general equilibrium models that are an important part of modern macroeconomics.

Our original report was designed to answer a "what-if" question: How much different would the GNP-PI have been if SFAS 106 were never adopted? As explained in our original report, the choice of a model was thoughtfully and deliberately based on a set of desirable criteria for a quantitative macroeconomic model. These criteria led to a quantitative general equilibrium model rather than a large-scale econometric macroeconomic model, and econometric estimates were taken from the economics literature to calibrate some of the key parameters of the model.

The philosophy that guided development and implementation of our model was one of conservatism. Recognizing the difficulty of precisely and accurately determining the exact effect of SFAS 106 on the GNP-PI, our model was designed to guard against understating the impact on the GNP-PI. Thus the baseline finding that the increase in the GNP-PI (0.0124%) will provide recovery of only 0.7% of increased costs due to SFAS 106 is designed to be an overestimate of the actual impact on the GNP-PI, and the baseline finding that 84.8% of the LECs' additional costs due to SFAS 106 remain unrecovered is meant to be an underestimate of the actual percentage.

Finally, MCI has pointed out that our August 14, 1995 report contains no new evidence. We did not present any new evidence because the conservatism in our original report was designed to guard against understating the impact of SFAS 106 on the GNP-PI even if new data turned out to be moderately different from the assumptions used in the study. Moreover, MCI has produced no substantive argument that would lead us to modify our findings in any way.

CERTIFICATE OF SERVICE

I, Liz Jensen, hereby certify that the foregoing Direct Case of Southwestern Bell Telephone Company, Rebuttal in Docket 94-157, has been served this 28th day of September, 1995 to the Parties of Record.

Liz Jensen

Liz Jensen

September 28, 1995

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